Trade Liberalization and the South Asian Economies: Adjusting to the Challenges of Globalization

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Abstract: The new round of WTO negotiations presents special opportunities and challenges for the South Asian countries. Active participation by South Asian countries may enable them to secure better market access for their exports. It may also preserve or secure changes in the existing regulations that will enable them to fully integrate in the global trading system, while allowing them to meet their developmental goals. However, to achieve a favorable agreement, South Asian countries, especially India, will need to reform their own protectionist trade and domestic policies. Despite significant trade liberalization within the last two decades, the regional supply of agricultural commodities remains constrained by trade restrictions and anti-agricultural bias in domestic policies. Reforming regional domestic and trade policies will facilitate negotiations, provide impetus for increased agricultural production, stimulate trade and further economic growth, and enhance the overall food security situation in South Asia.

Introduction

Despite significant improvements during the past two decades to combat poverty and hunger, more reform policies need to be adopted to improve food security in South Asia. With about 263 people for every square kilometer, South Asia represents the world's most densely populated region (World Bank, 1999). The region is characterized by large income disparities, with 43 percent of its population living below the poverty line (UNDP, 1997). The overall food supply, although sufficient in quantity, is not distributed uniformly, with Bangladesh and Nepal in danger of shortfalls. Trade is, therefore, vital in alleviating regional food shortfalls, and can also play an important role in generating further policy reform and economic growth. Exports from South Asia increased on average by over 12 percent annually during 1991-95, and the World Bank (1997) estimates that, led by India, South Asia has the potential to have the world's fastest growth in exports for the next 20 years. Exports from the region have also witnessed a large shift from primary agricultural products to manufactured goods, and a significant proportion of high-tech products—primarily from India.

South Asia—A Background Profile

South Asia's economy encompasses traditional village farming, modern agriculture, handicrafts, a wide range of modern industries, and a multitude of support services. Production, trade, and investment reforms implemented during the past two decades have provided new opportunities and generated faster economic growth. Unlike other Asian countries, this region has generally avoided financial problems, attracted some foreign investment, and revived confidence in economic prospects for the sub-continent. Although the overall macro-economic indicators in the region remain fairly strong, Pakistan is currently experiencing political and financial problems, government instability has plagued Nepal's economic development, and further policy changes are needed in India to restore the momentum of reform, especially by continuing reductions in the remaining government regulations.

Despite growing optimism for the region, South Asia's share of global trade has remained unchanged, around 1-percent. The primary exports from this region are textiles, garments, carpets, leather products, and agricultural commodities such as cotton, rice, and tea. In recent years, there has been a significant shift from food and primary product exports to exports of manufactured products. The share of manufactures in South Asia's total exports increased from 53 percent in 1980 to 76 percent in 1996 (World Bank, 1999). Although textiles and apparels dominate the manufactures exports, there is a small but increasing share of machinery and equipment exports from the region. Led by India, South Asia is also increasingly exporting science-based high technology products.

Capital and intermediate goods represent the major imports in South Asia. These include petroleum, petroleum products, machinery, fertilizer, and chemicals. Unlike Sub-Saharan Africa which largely depends on the European market for its trade, South Asia's trading partners are diverse and include Western Europe, as well as the United States, Hong Kong, Japan, and many other countries. Although the European

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Table D-1--Comparative Development Indicators

	GDP per capita	GDP growth	Trade share of GDP 1970	Trade share of GDP 1990	Regional trade share	Agriculture share of GDP	Labor force in agriculture
	$ U.S.	--- Percent ---					
Bangladesh	360	4.6	15	31	7	24	65
India	370	4.3	8	27	67	25	64
Nepal	220	1.7	13	64	1	41	83
Pakistan	500	2.5	22	37	16	25	52
Sri Lanka	800	5.9	54	80	9	22	48
South Asia	380		12	31	1(global trade) 2 (global ag trade)	25	63

Source: 1999 World Development Indicators, The World Bank. 1997 FAO data.

Union and the United States remain major destinations for South Asian exports, exports to East Asia have increased significantly in recent years, accounting for over 19 percent of total exports in 1995.

Regional trade within South Asia is limited, accounting for less than 4 percent of the region's total trade (World Bank, 1997). This figure does not take into account the illegal trade between neighbors, which is thought to be substantial. India maintains a growing trade surplus in the region with its 1995 regional exports accounting for 5 percent of its total exports. By contrast, its imports from the region account for only half a percent of its total imports. Regional trade in South Asia is hampered by India's protectionist policies and the long standing political conflict between India and Pakistan. India's refusal to provide transit facilities to Nepal and Bhutan for regional export, and its growing trade surplus are also considered by its neighbors to be impediments toward improving regional trade.

In December 1985, the South Asian countries formed the South Asian Association for Regional Cooperation (SAARC) to promote economic, social, and cultural cooperation. Members of SAARC include Bhutan and Maldives in addition to the five countries covered in this paper (Bangladesh, India, Pakistan, Nepal, and Sri Lanka). Due to the ongoing political conflict between India and Pakistan, SAARC has achieved little in promoting regional economic cooperation.

In 1993, the South Asian Preferential Trade Agreement, SAPTA, was initiated to promote greater regional economic cooperation. Although SAPTA allows for negotiations on a sectoral basis, the approach taken to date has been to negotiate trade concessions on a product-by-product basis. Therefore, except for a few minor tariff concessions, not much has been accomplished through SAPTA. Studies on regional integration in South Asia point out that unilateral trade liberalization rather than regional trade arrangements will be most beneficial for South Asia (de Melo and Rodrik, 1993). However, other studies indicate that the small economies in the region, such as Nepal and Bangladesh, would gain considerably from a regional trade agreement (Srinivasan, 1994).

Excepting Nepal, which has a very open trade policy, trade in South Asia has been inhibited by restrictive and interventionist government policies. Import tariffs are high, averaging about 39 percent between 1994-98, compared with about 6 percent for OECD countries (UNCTAD, 1994 and 1999). Nontariff barriers, such as quantitative restrictions on imports and the control of imports by parastatal government monopolies, are prevalent in the region. Exports of many commodities are also restricted or controlled by parastatal monopolies designed to manage domestic supply and to protect the domestic manufacturing sector. Despite these barriers, South Asia has come a long way since the early 1970s in opening its market to imports. Current tariffs, although very high, are less than half of those prevailing in the 1970s, the frequency of nontariff barrier use has declined by about 85 percent (UNCTAD, 1994 and 1999), and parastatal control of commodity trade is currently limited primarily to India.

Government policies in South Asia have historically discriminated against agriculture through measures designed to protect the manufacturing sectors. The policies include exchange rate overvaluation, direct control of agricultural commodity trade, and taxes on agricultural exports (Pursell, 1999).

Nevertheless, agriculture has remained an important sector in the economy, accounting for about 25 percent of total GDP and employing over 60 percent of the labor force. In 1997, South Asia produced 29 percent of the world's rice crop, 24 percent of the world's cotton, 15 percent of the world's wheat, and 11 percent of the world's oil crops (FAO, 1999).

South Asia is generally self-sufficient in cereals and the overall food supply, expressed as 2,449 calories per capita per day, exceeds the FAO recommended minimum level of 2,100 calories. However, this figure is below the world average of 2,782 calories per capita per day. Moreover, the food supply is not distributed evenly in the region, and the 1997 per capita daily calorie supply in Bangladesh was below the FAO recommended nutritional minimum. USDA/ERS projections of supplies of grain and other commodities in Bangladesh suggest that per capita calorie supplies will not increase over the next 10 years. Although, excepting Bangladesh, projected regional food supplies are sufficient

Table D-2--Food Availability Indicators

	Wheat production	Rice production	Cereal self-sufficiency	Per capita daily calorie supply
	------1,000 mt-------		Percent	Number
Bangladesh	1,803	28,293	88	2,085
India	66,000	122,244	100	2,496
Nepal	1,030	3,641	105	2,366
Pakistan	18,694	6,587	94	2,476
Sri Lanka		2,692	54	2,302
South Asia	87,532	163,507	98	2,449
World	588,841	563,188		2,782
South Asian share of world production (%)	15	29		

Source: 1997 FAO data.

to meet the minimum nutritional requirements of the population, regional per capita food availability is expected to decline between 1999 and 2009.

The share of food aid in South Asia's total imports has declined during the 1990s. However, food aid continues to play an important role in meeting food demand in the region, exceeding 1.2 million metric tons in 1997. Bangladesh received over 44 percent of the region's food aid in 1997, while India, Pakistan, and Bangladesh together accounted for about 90 percent of the total aid. Although food aid's share of total food imports has generally declined, it has been increasing in Nepal. This reflects Nepal's increasing vulnerability to food shortfalls due to growing population pressures and a sluggish economy.

Economic Policies and Performance

Starting with Sri Lanka in the 1970s, South Asian countries embarked on an economic liberalization that accelerated significantly in the 1990s. The liberalization was driven by a general disenchantment with economic planning implemented in individual countries, and the feeling that the region was missing the growth and development opportunities that East Asian countries were enjoying. Multilateral trade negotiations did not influence the liberalization process. The process was, however, facilitated by substantial devaluation of South Asian currencies that occurred between the 1980s and 1990s. For example, the Indian rupee was devalued in real terms by about 130 percent between 1985 and 1992.

Table D-3--Share of Food Aid in Total Food Imports

	Share of food aid in total imports		Food aid	Food imports
	1991	1997	1997	1997
	----Percent-------		----Metric tons----	
Bangladesh	76	44	548,340	1,257,553
India	32	8	310,251	3,879,714
Nepal	8	25	40,833	164,714
Pakistan	22	7	203,551	2,997,453
Sri Lanka	29	6	137,669	2,392,491
South Asia	41	11	1,245,903	10,840,607

Source: FAO.

In recent years, reform in government policies has also been undertaken under the International Monetary Fund's (IMF's) structural adjustment program. Nevertheless, trade liberalization has not been uniform within the sub-continent, with India, Bangladesh, and Pakistan still implementing several interventionist policies. Between 1970 and 1997, Nepal's indicator of trade openness (measured as total imports plus exports as a percentage of GDP) increased from 13 to 64 percent. Although Sri Lanka's trade openness indicator changed by only 26 percent, Sri Lanka has a relatively open economy, as indicated by its 1997 trade openness measurement of 80 percent. The remaining three countries, especially India with the lowest measure at 27 percent, would benefit from further reform to liberalize their trade.

Market access reform in South Asia, in general, was launched with the objective of streamlining procedures, reducing and harmonizing tariffs, and gradually removing import prohibitions. The average applied tariff rate on imports decreased about 37 percent between the 1980s and 1990s (UNCTAD, 1994 and 1999). However, current tariff rates remain high, averaging about 39 percent. There is a large difference in applied tariff rates across the region. Nepal has no tariffs on primary products, and tariffs on most other products range between zero and 20 percent (Pant, 1999). The applied tariff rates in India and Pakistan, on the other hand, often exceed 50 percent (Sharma 1999; Qureshi, 1999).

South Asia's nontariff barriers declined more than 85 percent between the 1980s and 1990s (UNCTAD, 1994 and 1999). Nevertheless, import restrictions and prohibitions remain on over a quarter of all tariff lines in India and on a very small number of commodities in other South Asian countries (Athukorala and Kelegama 1999; Chowdhury et al. 1999). Given the recent WTO ruling against India, on a case brought up by the United States, the Government of India is expected to accelerate the phase-out of all import restrictions.[2]

Export restrictions, licensing, monopoly control, and export taxes generally burdened the agricultural sector in South Asia. Since the reform policies implemented in the 1990s, export restrictions have been removed on almost all agricultural commodities in Bangladesh, Pakistan, and Sri Lanka, and on a number of agricultural commodities in India. However, parastatal control of exports and licensing requirements continue to inhibit the export of most major agricultural commodities in India and some agricultural commodities in Pakistan.

South Asia's domestic policies in the 1990s have been characterized by reform measures such as privatization of state enterprises, reduction of subsidies to industries, liberalization of capital markets, and other reforms that encourage trade and foreign investment. Liberalization of trade regimes and deregulation of domestic markets have created new business and export opportunities. Although the overall climate in the region looks very promising, there are significant hurdles on the horizon. Sri Lanka's robust economy is constantly burdened by the fighting between the Sinhalese and the minority Tamils. Bangladesh's progress is often halted by recurring natural disasters. Pakistan has been battling financial problems stemming from years of loose fiscal policies. Nepal's growth is inhibited by its landlocked geographic position and the frequent change of governments. Finally, India's economic growth has been hampered by the slow pace with which the government implements reform.

What Were the Estimated Impacts from the Last Round on South Asian Countries?

Most of the studies that looked at the impact of the Uruguay Round on developing countries noted that the implementation of the Uruguay Round may marginally increase agricultural commodity prices (Goldin and van der Mensbrugghe, 1996; Ingco, 1997). However, analysis of agricultural commodity prices indicates that such increases did not occur. Studies on the Uruguay Round's impact also point out that the negative impacts of increased food prices on consumers can be more than offset by gains arising from reforms in domestic policy. All studies emphasize that the gains from multilateral trade agreements are particularly large in developing countries that open their trade regimes. In general, the studies have estimated the impacts of the Uruguay Round on South Asia to be positive (Ingco, 1997; Sharma et al., 1999).

For a major agricultural producing region such as South Asia, where yields (despite some improvements brought about by the Green Revolution) have remained well below the world average, increased commodity prices and reduction of trade barriers provide incentives for increased production and exports. Sharma et al. (1999) indicate that the Uruguay Round Agreement may result in a net trade surplus of over US$1.3 billion in South Asia, with food imports reduced by about $1 billion and additional exports of about $300 million.

The manufacturing sector of South Asia, which produces mainly textiles and apparel, has actually been estimated to benefit more from the Uruguay Round than agriculture (Majd, 1995). The eventual elimination of the Multi-Fibre Arrangement (MFA) by 2005 is expected to increase South Asia's textile output by 17 percent and exports by 26 percent. Hertel et al. (1996) have further argued that the gains from MFA reform will amount to about 27 percent of South Asia's overall gains from implementation of the Uruguay Round Agreement. Martin (1999) points out that although South Asian textile and apparel industries are poised for rapid growth, South Asia will need to implement complementary domestic policy reform to take full advantage of the MFA reform.

WTO Issues Particularly Important To South Asia

Market access for export commodities is a top priority for South Asia, especially access for textiles and apparel. Tariffs on textiles and apparel were generally excluded from the Uruguay Round reduction commitments and have remained high. Because the MFA will be fully implemented by 2005 and textiles may not be on the negotiating table, tariffs on textiles will be a difficult issue to tackle in the next trade negotiations. It has often been noted that importing countries have chosen to phase out textile quotas in such a way that very little liberalization occurs during the phase-out period (Martin, 1999). Exporting countries, including South Asian countries, are concerned that having deferred a significant proportion of the liberalization to the end of the phase-out period, it may be politically impossible for importing countries to carry out their Uruguay Round obligations by 2005.

Maintaining, in some form, the provisions of the "special and differential treatment" accorded to developing countries under the Uruguay Round Agreement is important for South Asia. The value of this provision has often been debated by those who question whether exemptions and lesser reform requirements for developing countries have contributed to their smaller gains from the Uruguay Round Agreement. Nevertheless, special provisions, especially those that will provide flexibility in reducing domestic support measures, are very important to South Asian countries. Many developing countries, including South Asian countries, did not set up a domestic support reduction schedule after the Uruguay Round Agreement, thus precluding themselves from implementing support programs for agriculture outside of "Green

[2] In April 1999, a WTO Dispute Settlement Panel ruled that India's continued use of quantitative restrictions on imports of a wide range of consumer goods under the Balance of Payments provisions of GATT Article XVIII:B was inconsistent with the GATT guidelines and called for their removal.

box” policies and in excess of *de minimus* levels (see Overview table A-1).

However, the special and differential treatment provisions currently allow developing countries to implement these programs to support their agricultural and rural sectors. If the special and differential treatment provisions are not extended in the a round, many developing countries will be unable to provide any support to their agriculture. South Asian countries are also concerned that the current domestic support provisions do not take into consideration the impacts of inflation and currency exchange rate fluctuations on a country’s ability to comply with its WTO obligations.[3]

Given the important role that imports and food aid play in meeting South Asia’s food demand, most countries in the region consider it a priority that a new round take into consideration the concerns of net food-importing developing countries and adopt measures to ensure that the outcome does not result in higher food prices and decreased food availability. South Asian countries, like many other net food-importing countries, seek assurances from exporting countries that food export supplies will remain reliable and not subject to sudden restrictions. Additionally, importing countries also argue that since global food sufficiency does not always address local food insecurity concerns, especially when the purchasing power of a food-insecure country is limited, a new round will need to consider special measures to address food security concerns of food-importing countries.

Conclusions

The next round of WTO negotiations represents an opportunity for South Asian countries to seek better access for their export products, especially textiles. Further reform of the global trading system will likely require accelerated reform in the domestic policies of South Asian countries. Reforms in domestic policy and global trade rules have the potential to propel additional growth in a region that is already on a rising economic growth path.

Reform in domestic policies and agricultural trading rules will create incentives to remove the anti-agricultural bias existing in the region. This should lead to significant increases in agricultural production in the sub-continent, where average yields are well below the world average. Likewise, South Asia’s manufacturing sector, especially textiles and apparel, is estimated to be poised for major expansion with the impending open trade environment. Increased food production, and rising economic growth brought about by trade liberalization should substantially enhance regional food security and improve general living conditions for many in the region.

[3] Under the Uruguay Round Agreement on Agriculture, the comparison of current domestic support with the base period support level is done using nominal prices. The use of nominal prices can cause current support to exceed the base levels even when the actual level of support has decreased.

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